

# SIGIR Observations

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This is the tenth Quarterly Report from the Special Inspector General for Iraq Reconstruction (SIGIR). During this reporting period, several positive effects of the U.S. reconstruction program became evident. Significantly, over the past six weeks, the production of both electricity and oil in Iraq climbed above pre-war levels. Electricity output nationwide now exceeds 5,000 megawatts, and oil production reached 2.5 million barrels per day. Both of these levels are the highest achieved in more than a year.

These accomplishments are critical as the U.S.-led phase of Iraq's relief and reconstruction moves towards its conclusion. The next

phase must be multilateralized, which means more international effort and investment. This multilateral phase will be energized by the development of a new international financial compact for Iraq, which is expected to generate broader support for reconstruction while requiring Iraq to meet specific political and economic milestones. The compact anticipates increased commitments from international donors, and thus it will serve as a bridge between the U.S.-led phase and a more extended and comprehensive reconstruction and recovery program, which Iraq itself must ultimately fund and execute. *See below*, "The Next Phase: Multilateralizing Reconstruction."

## YEAR OF TRANSITION: PUSHING THROUGH THE MIDPOINT

By the end of June 2006, \$18.94 billion of the combined U.S. Iraq Relief and Reconstruction Fund (IRRF 1 and IRRF 2)<sup>1</sup> had been obligated, and \$14.85 billion had been expended. On September 30, 2006, the U.S. government's authority to obligate the IRRF will expire. Consequently, any unobligated IRRF dollars must be put under contract by the end of September, or the funds will revert to the U.S. Treasury.

In light of these circumstances, the Joint Contracting Command-Iraq and other contracting entities are currently focused on obligating all remaining IRRF dollars as rapidly as possible. Although the IRRF must be entirely obligated by September 30, funds may be

de-obligated and subsequently re-obligated after this date. Thus, there should be continuing oversight of plans to de-obligate and re-obligate funds to ensure that the IRRF continues to be used to meet Iraq's highest reconstruction priorities.

The U.S. Army Corps of Engineers-Gulf Region Division (GRD) and the Project and Contracting Office (PCO) plan to begin drawing down staff later this year based on projected workload reductions. Additionally, the Iraq Reconstruction Management Office (IRMO), a temporary agency funded by the IRRF, is slated to terminate in 2007. The Department of State (DoS), however, has requested funding for

IRMO in its FY 2007 budget so that it can continue to support capacity building and other reconstruction initiatives. SIGIR supports this decision and observes that sufficient personnel should remain with GRD, PCO, and IRMO until the IRRF is fully executed.

During this reporting period, the most significant event in the Year of Transition occurred: the first permanent, democratically elected government of Iraq took office with the inauguration of a new Prime Minister, the seating of a new assembly, and the appointment of a full complement of ministers. This is the third Iraqi government since the CPA transferred sovereignty back to Iraq on June 28, 2004. The war-weary Iraqi populace expects the new government to provide stability and security. However, the enormity of the violence in Iraq during the last quarter underscores the tenuous nature of this expectation.

Along with security, sustainment remains a critical challenge confronting the new Iraqi government. Sustainment means ensuring that Iraq has the capacity to manage and support the programs, projects, and assets that the U.S. will transfer to it. SIGIR raised sustainment as a significant concern last year, and U.S. reconstruction managers responded by developing new transition plans that more fully addressed the issue. IRMO commendably created an office to ensure adequate planning for the sustainment of IRRF projects. But concerns remain about Iraq's capacity to operate its expanded and modernized infrastructure. The lack of effective budgeting by Iraq to fund the operation and maintenance of its major infrastructure sectors is a continuing and potentially crippling weakness. SIGIR's audit of transition this quarter is summarized in Section 3 of this Report.

## SECURITY: A LETHAL PROBLEM

Attacks, kidnappings, and threats against contractors and Iraqi officials continue to hinder reconstruction efforts. Moreover, the lethal environment in Iraq restricts the movement of U.S. government personnel, thus limiting the number of Americans working in Iraqi ministries. This inhibits U.S. efforts to build capacity within the Iraqi system. The deteriorating security situation has had a particularly deleterious effect on the establishment of the U.S. Provincial Reconstruction Teams (PRTs), only five of which have begun operations in Iraq. The PRT concept was developed to address the issue of inadequate government capacities at

the provincial level. *See below*, "Capacity Building: Keystone to Transition."

As U.S. and other coalition forces reduce their operational presence in certain areas, the burden of resolving the security problem is increasingly an Iraqi responsibility. In addition, budget constraints have limited the presence and effect of private security contractors. Iraqi ministries are spending more resources on security, which drains capital from other key reconstruction programs. SIGIR completed a classified audit on infrastructure security during this quarter.

## CORRUPTION: ENDEMIC AND DESTRUCTIVE

There continues to be evidence of pervasive corruption within the Iraqi government. Transparency International ranks Iraq among the most corrupt countries in the world. The Deputy Prime Minister of Iraq recently told SIGIR that corruption “threatens the state.” The Inspector General for the Ministry of Health, who chairs the Iraq Inspectors General Council, recently estimated that corruption costs Iraq \$4 billion each year. And reports from other Iraqi inspectors general and the Commissioner of Public Integrity—who is pursuing more than 1,400 cases involving \$5 billion in suspected fraud and other criminal activity—substantiate the belief that corruption is a virtual pandemic in Iraq. A recent nationwide survey of Iraqis revealed that, over the past 12 months, one third of those polled had paid a bribe to obtain products or services. This survey also indicated a core mistrust of the police and army, who are believed to be unable or unwilling to enforce the rule of law.

Although some of Iraq’s anticorruption entities are gradually gaining strength, they need stronger support from the Iraqi government and a clearer division of responsibilities among them. Successfully addressing corruption in Iraq is indubitably a multi-generational process, but the severity of the current problem begs for a better-resourced effort. The Iraqi Prime Minister is exploring strategies to combat corruption, and expectations are that he will provide more direct support for this important effort. Significantly, in late July, the World Bank hosted an anticorruption workshop in Dubai that brought Iraqis and donors together to examine how the World Bank and others can more effectively assist in the fight against corruption. Finally, the U.S. Mission in Iraq concurred with the recommendations in a recent SIGIR audit on U.S. anticorruption capacity-building efforts. See Section 3 of this Report for a summary of that audit.

## RECONSTRUCTION LEADERSHIP: MORE COORDINATION NEEDED

A SIGIR audit this quarter revealed that more coordination is needed among the various implementing agencies involved in transition. IRMO is responsible for setting the reconstruction program’s priorities, coordinating among the implementing agencies, central-

izing reporting on IRRF implementation, and managing the advisors to Iraq’s ministries. But IRMO has yet to bring all agencies together to effectively address transition issues such as sustainment and capacity building.

It remains unclear to what extent particular

Iraqi ministries have the capacity to manage and financially support the projects that are being transferred to them; SIGIR's audit of transition planning found a lack of coordination by U.S. entities. In the months ahead,

IRMO should be empowered to exercise greater authority in coordinating the work of all operating agencies engaged in the reconstruction program's transition.

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## CAPACITY BUILDING: KEYSTONE TO TRANSITION

The U.S. government continues to advance capacity-development programs in Iraq's ministries and provinces. For the past four decades, Iraq was a statist economy with a highly centralized administration. Baghdad drove budgeting and service delivery through ministries that funded the provinces. The decentralization of authority that followed the fall of Saddam's regime (and was encouraged by the Coalition Provisional Authority) had the effect of empowering inexperienced local officials to manage the delivery of provincial government services.

The consequences of this devolution in decision-making required the United States and other donors to establish programs aimed at developing local capacities. U.S. programs to

support these capacity-building efforts now have a high priority, but they must remain sensitive to the tensions that have arisen between national and provincial authorities in Iraq.

The leading U.S. capacity-building initiative outside Baghdad is the PRT program, which seeks to help local officials develop a sustained capacity to govern and promote security, rule of law, political participation, and economic development. SIGIR visited several of the PRTs this quarter and found that the program currently faces serious challenges, including security threats, insufficient staffing, and limited resources. Moreover, the program's implementation is behind schedule. SIGIR has announced an audit of the PRT program, which will be executed in the coming quarter.

## THE NEXT PHASE: MULTILATERALIZING RECONSTRUCTION

At the request of the Iraqi Prime Minister, the United Nations recently began discussions aimed at helping Iraq negotiate a new financial compact with international donors. The compact anticipates increased donor support tied to commitments by Iraq that address economic development, security threats, political reform, and corruption. The compact is expected to energize the next phase of the reconstruction program as the U.S. role gradually diminishes and multilateral engagement increases. U.S. reconstruction officials have already taken significant steps to engage the Iraqi government in preparing for this next phase.

The compact is likely to require additional U.S. funding for the Iraq reconstruction effort. The World Bank and other international lending institutions typically include conditionality in their funding programs. In the same vein, future U.S. funding should impose enforceable conditions on the Iraqi government by applying clear and measurable performance milestones. This approach comports with standard U.S. foreign aid practices. Requiring Iraq to meet measurable milestones should motivate the Iraqis to make the difficult policy decisions (such as subsidy reductions) necessary for the nation's long-term growth and development.

## NOTABLE SIGIR ACTIVITIES THIS QUARTER

In the course of performing its oversight mission this quarter, SIGIR issued 10 audits, which made 50 recommendations, and SIGIR's 13 project assessments presented numerous reconstruction-related findings. SIGIR investigations obtained guilty plea agreements this quarter, and SIGIR entered into a cooperative agreement with the FBI's Criminal Investigative Division that will strengthen SIGIR's investigative efforts in Iraq and the United States.

SIGIR has completed its second lessons

learned report, *Iraq Reconstruction: Lessons in Contracting and Procurement*. This report provides detailed insights into the U.S. government's contracting experience in Iraq, along with six recommendations for improving the U.S. government's approach to contracting during contingency operations. To its credit, the Department of Defense, after reviewing the report's draft recommendations, formed a task force to begin exploring methods to implement the recommendations.

### Audits

During this quarter, SIGIR completed 10 final audit reports, bringing to 65 the total number of SIGIR audits issued to date. The audits address a wide range of issues, including an examination of health sector projects and new reviews of security and anticorruption activities. SIGIR has 14 ongoing audits and has issued 2 draft reports for comment; 5 new audits are in the planning stages for next quarter. SIGIR performs audit work under generally accepted government auditing standards prescribed by the U.S. Comptroller General.

#### **BASRAH CHILDREN'S HOSPITAL**

SIGIR reviewed the Basrah Children's Hospital Project, a USAID program that the contractor, Bechtel, originally agreed to complete by December 31, 2005. For a variety of reasons, including an increasingly hostile security environment, the project fell well behind schedule. On March 26, 2006, Bechtel informed USAID that the hospital could not be completed until July 31, 2007. In addition, the contractor reported that its estimated cost-to-complete had increased by 96%, and that final costs were projected to be more than 200% above the initial estimated cost for construction. In its review, SIGIR identified many reporting anomalies, including weak accounting systems and poor cost-projection processes.

### SECURITY

On the security front, SIGIR conducted a classified audit, "Review of Efforts To Increase Iraq's Capability To Protect the Energy Infrastructure," and an examination of the Advanced First Responder Network (AFRN) project. In the latter audit, SIGIR identified significant deficiencies in the AFRN, which was intended to provide an integrated, national communications system for security forces and first responders. The United States is currently closing out the AFRN project, and it will soon be turned over to the Multi-National Security Transition Command-Iraq and the Ministry of Interior. SIGIR's audit found that the AFRN project has yet to produce an effective, nationwide command-and-control communications system. And it does not provide an effective means to dispatch and direct first responders at the governorate level.

### ANTICORRUPTION

The U.S. government has been working with the Iraqi government to establish organizations, systems, and training to fight corruption and increase the transparency and accountability of government. SIGIR completed a review of these efforts this quarter and found that the U.S. government's expenditures on anti-corruption activities have been quite modest when compared to the total expended on Iraq reconstruction. Less than .003% of total IRRF funding (approximately \$65 million) has been identified for ongoing and planned anticorruption activities.<sup>2</sup>



## Inspections

SIGIR completed 13 project assessments this quarter. To date, SIGIR has completed 56 project assessments, 96 limited on-site inspections, and 172 aerial assessments. This quarter, SIGIR found that most IRRF projects evidenced high-quality workmanship and had good quality-control and quality-assurance programs in place. Contractor performance, however, continues to be an issue. SIGIR identified contractor design deficiencies at certain sites, including:

- The contractor failed to properly coordinate, plan, and execute the 50-kilometer pipeline project from Kirkuk to Al Fatah. As a result, the Iraqi government has been deprived of potential oil revenue.
- The U.S. government did not verify the quality of contractor work and the truth of contractor claims of completeness on the Riyadh and Zegeton canal crossing projects.

Except for the oil pipeline and canal crossing projects, the quality assurance conducted by the U.S. Army Corps of Engineers on the other nine projects visited by SIGIR this quarter met all requirements.

## Investigations

During the last quarter, SIGIR investigations opened 40 new preliminary and criminal investigations involving a variety of offenses, ranging from contract fraud, bribery, and larceny to kickbacks and gratuities. During the same time period, SIGIR unsubstantiated

and closed 25 cases. Currently, SIGIR has 82 open preliminary and criminal investigations. Twenty-five of those cases are currently awaiting prosecution at the Department of Justice (DoJ). Two of those cases have resulted in convictions and are pending sentence, and DoJ is reviewing two additional cases to determine whether to prosecute.

On July 7, 2006, DoJ entered a plea agreement with LTC Bruce Hopfengardner, USAR. LTC Hopfengardner agreed to plead guilty to conspiracy to commit wire fraud and money laundering. Hopfengardner allegedly conspired with CPA Comptroller and Funding Officer Robert Stein to steer millions of dollars worth of construction contracts to a company owned by Phillip Bloom. Under the plea agreement, the maximum penalty that may be imposed is 25 years in prison. A date for the court to accept the plea has not been set.

SIGIR recently entered into a partnership with the Federal Bureau of Investigation's (FBI) Criminal Investigations Division to enhance investigative operations in Iraq and the U.S. SIGIR investigators continue to work closely with Iraq's Commission on Public Integrity, the DoS Office of Inspector General, the Major Procurement Fraud Unit in the Office of Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigations, and other partners participating in the Special Investigative Task Force for Iraq Reconstruction.

## FINANCIAL IMPACT OF SIGIR OPERATIONS

SIGIR oversight has produced tangible financial benefits. SIGIR audits have saved \$10.9 million, recovered \$1.4 million, and improved the use of \$20.6 million. SIGIR has challenged payments of \$306.9 million, which included possible duplicate payments, overpayments, and payments for work that was not completed. SIGIR also made recommendations that improved property accountability valued at \$65.3 million.

The net potential beneficial impact of SIGIR audits is approximately \$405.1 million, as of

July 30, 2006. SIGIR inspections have produced recommendations that could potentially increase Iraqi oil revenues by \$1.277 billion annually. SIGIR investigations report that \$13 million in cash and assets has been seized or recovered in the course of SIGIR investigations. For the data supporting these benefits, see Appendix J.

The next table presents an overview of the issues in Iraq reconstruction raised by SIGIR since July 2005.

### SIGIR OBSERVATIONS, SUMMER 2005 – SUMMER 2006

	7/30/05	10/30/05	1/30/06	4/30/06	7/30/06
1. Cost-to-complete data was not gathered, analyzed, provided.	X	X	X		
2. The sustainability of U.S.-funded projects must be addressed.	X	X	X		
3. Enhance strategy/interagency coordination.	X	X	X		
4. Improve program management.	X	X	X		
5. Improve information systems management.		X	X		
6. Improve acquisition/contract management.	X	X			
7. Appropriate use of contracting.		X			
8. Human Resources lessons learned.	X	X			
9. Managing the security crisis.	X	X	X	X	
10. Identify and close the Reconstruction Gap.		X	X	X	X
11. Promote anticorruption in Iraq.		x	X	X	
12. Critical Issues for the Year of Transition.			X	X	
13. Protect the infrastructure.				X	X
14. Energize the oil and gas sector.				X	X
15. Encourage international aid and investment.				X	
16. Build the Iraq government's capacity to perform.					X
17. Multi-lateralize the relief and reconstruction program.					X
18. Tie future U.S. funding to conditionality.					X
19. Promote transparency in the repatriation of Iraqi assets.					X

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## THE HUMAN TOLL

The lethal environment in Iraq continues to take a deadly toll on those working to rebuild the nation. In many parts of the country, contractors and subcontractors face intimidation and violence on a daily basis. This quarter, the Department of Labor reported 56 new contractor death claims, which brings the total to 575 since March 2003. Moreover, DoS reports a total of 185 deaths of U.S. civilians in Iraq in the same time period.

Attacks on Iraqi civilians by insurgents, militias, and terrorists continued to rise in Iraq this quarter, according to the UN Assistance Mission for Iraq.<sup>3</sup> During May and June 2006, 5,818 civilians were reportedly killed, and at least 5,762 were wounded. On June 25, the Ministry of Health estimated that at least 50,000 persons have been killed violently in Iraq since 2003.